

Message Text

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ACTION EB-11

INFO OCT-01 EUR-25 IO-14 ISO-00 AID-20 CIAE-00 COME-00

FRB-02 INR-10 NSAE-00 RSC-01 TRSE-00 XMB-07 OPIC-12

SPC-03 CIEP-02 LAB-06 SIL-01 OMB-01 SAM-01 NSC-10

SS-20 STR-08 CEA-02 FEA-02 SCI-06 INT-08 L-03 H-03

PRS-01 PA-04 USIE-00 AGR-20 NEA-11 FPC-01 AEC-11 EA-11

AF-10 ARA-16 SSO-00 INRE-00 NSCE-00 DRC-01 /265 W

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FM USMISSION EC BRUSSELS

TO SECSTATE WASHDC IMMEDIATE 6357

INFO AMEMBASSY BONN

AMEMBASSY BRUSSELS

AMEMBASSY COPENHAGEN

AMEMBASSY DUBLIN

AMEMBASSY LONDON

AMEMBASSY LUXEMBOURG

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LIMITED OFFICIAL USE SECTION 1 OF 2 EC BRUSSELS 0608

STATE ALSO FOR T/IEP

PASS TREASURY, FRB AND CEA

E.O. 11652: NA

TAGS: ENRG, EFIN, EEC

SUBJECT: ENERGY: PRELIMINARY EC COMMISSION

DRAFT ON REPERCUSSIONS OF ENERGY

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SITUATION ON PRODUCTION, EMPLOYMENT,

PRICES, BALANCE OF PAYMENTS AND
MONETARY RESERVES IN THE EC

REFS: A. EC BRUSSELS 0201
B. STATE 007324
C. EC BRUSSELS 0330
D. EC BRUSSELS 0416

1. SUMMARY. THE EC COMMISSION'S PRELIMINARY DRAFT (OBTAINED IN CONFIDENCE BY THE MISSION) ON THE ECONOMIC AND FINANCIAL CONSEQUENCES OF THE ENERGY SITUATION CONTAINS THE FOLLOWING ESTIMATES FOR THE EC IN 1974: (A) THE GENERAL LEVAL OF OIL-INDUCED PRICE INCREASES WILL BE 2-3 PERCENT; (B) PRODUCTION WILL BE 1.5 PERCENT LESS THAN PREVIOUSLY EXPECTED AND REAL GROWTH WILL NOT EXCEED 2-3 PERCENT; (C) NET DETERIORATION IN THE EC CURRENT ACCOUNT WILL BE \$17.5 BILLION, WHICH CORRESPONDS TO 1.5 PERCENT OF GNP.

2. THE PAPER WARNS AGAINST THE DANGERS OF DISEQUALIBRATING CAPITAL MOVEMENTS, COMPETITIVE PROTECTIONIST MEASURES, AND GENERALLY INCOMPATIBLE ECONOMIC POLICIES BUT CONTAINS NO POLICY RECOMMENDATIONS ON DEMAND MANAGEMENT.

3. THE FINAL VERSION OF THE PAPER, DUE TO BE APPROVED SHORTLY BY THE COMMISSION, MAY OMIT POLICY CONSIDERATIONS. THE FIGURES, HOWEVER, ARE EXPECTED TO REMAIN THE SAME. END SUMMARY.

4. THE MISSION HAS OBTAINED ON A CONFIDENTIAL BASIS THE FRENCH LANGUAGE TEXT OF A PRELIMINARY DRAFT OF THE COMMISSION'S PAPER ON THE ECONOMIC AND FINANCIAL REPERCUSSIONS OF THE ENERGY SITUATION. THE DOCUMENT IS SUMMARIZED BELOW. THE COMMISSION STILL CONSIDERS THE DRAFT SECRET, ALTHOUGH SOME OF THE FIGURES HAVE LEAKED TO THE PRESS (THE ECONOMIST, JAN. 26, 1974.) THE PAPER IS WITHOUT SURPRISES AND IS ALONG THE LINES INDICATED IN REFS A, C, AND D. OUR CONTACTS TELLS US THE COMMISSION STILL HAS NOT DECIDED WHETHER THE FINAL VERSION WILL CONTAIN BROAD POLICY STATEMENTS, AS IN THIS DRAFT, LIMITED OFFICIAL USE

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OR WHETHER IT WILL BE PRIMARILY NUMERICAL ESTIMATES. IN THE LATTER CASE, SOME BROAD POLICY RECOMMENDATIONS WOULD BE INCLUDED IN A "STATE OF THE COMMUNITY" MESSAGE THAT IS REFERRED TO AT THE END OF THE DOCUMENT AND WHICH COMMISSION PRESIDENT ORTOLI PROMISED ON JANUARY 20 TO SUBMIT TO THE COUNCIL SHORTLY.

5. BEGIN SUMMARY OF DOCUMENT:

GENERAL ANALYSIS. FINANCIAL AND PRICE QUESTIONS HAVE NOW BECOME CENTRAL ASPECTS OF THE OIL CRISIS. ADDITIONAL RECEIPTS OF OIL EXPORTING COUNTRIES COULD REACH \$60 BILLION IN 1974 AND BE EQUAL TO MORE THAN 10 PERCENT OF THE COMMUNITY'S GNP IN THREE YEARS.

6. JAPAN, EUROPE AND THE DEVELOPING COUNTRIES WILL SHARE IN PRINCIPAL BURDEN OF HIGHER OIL PRICES, ALTHOUGH THE EFFECTS ON THE U.S. TRADE BALANCE WILL ALSO BE CONSIDERABLE. AS THEIR CURRENT ACCOUNTS DETERIORATE, INDUSTRIALIZED COUNTRIES COULD IMPOSE RESTRICTIONS ON AID TO THE DEVELOPING COUNTRIES WHICH, WHEN ADDED TO HIGHER ENERGY COSTS, COULD HAVE A SERIOUS EFFECT ON THE ECONOMIC DEVELOPMENT OF THESE COUNTRIES.

7. THE DANGER OF MASSIVE AND DISORDERLY CAPITAL MOVEMENTS MAY INCREASE. MOREOVER, GROWTH IN THE MASS OF SPECULATIVE CAPITAL COULD FACILITATE THE FINANCING OF SPECULATIVE STOCKS OF RAW MATERIALS.

8. DOMESTIC PRICE INCREASES AND BALANCE OF PAYMENTS DEFICITS WILL AFFECT ECONOMIC ACTIVITY AND EMPLOYMENT, CAUSING A REAL RISK THAT INDUSTRIALIZED COUNTRIES MAY FOLLOW INCOMPATIBLE ECONOMIC POLICIES. PAYMENTS DEFICITS MAY CREATE PRESSURES FOR COMPETITIVE PROTECTIONIST MEASURES. SOME COUNTRIES MIGHT BE INDUCED TO ADOPT POLICIES TO REFLATE DEMAND. OTHER COUNTRIES, FACING PRICE INFLATION AND WORSENING CURRENT ACCOUNTS, MIGHT RESTRAIN INTERNAL DEMAND. THIS SITUATION COULD LEAD TO COMPETITIVE MEASURES IN EXCHANGE RATES, INTEREST RATES AND CAPITAL MOVEMENTS.

9. THE ENERGY CRISIS IS NOT SIMPLY A QUESTION OF LIMITED OFFICIAL USE

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FACINT A TEMPORARY SHORTAGE OF AN ESSENTIAL MEANS OF PRODUCTION. RATHER, IT THREATENS ECONOMIC STRUCTURES WORLDWIDE AND CONSTITUTES A CHALLENGE TO FUTURE COMMUNITY POLICY.

10. REPERCUSSIONS OF THE CRISIS ON THE COMMUNITY.

(A) OIL SUPPLY SITUATION. DELIVERIES TO THE COMMUNITY DURING THE FIRST QUARTER OF 1974 WILL NOT EXCEED 137 MILLION TONS OF CRUDE OIL AS AGAINST 141 AND 161 MILLION TONS RESPECTIVELY IN THE FIRST AND THIRD QUARTERS OF 1973. THE MOST AFFECTED COUNTRIES WILL BE ITALY AND THE NETHERLANDS. A RETURN TO NORMAL DELIVERIES IS EXPECTED AFTER THE WINTER, SO THAT FOR THE YEAR AS A WHOLE THESE SUPPLY RESTRICTIONS SHOULD NOT HAVE A MAJOR IMPACT ON IMPORTS -- ASSUMING CON-

SERVATION MEASURES AND A CERTAIN PRICE ELASTICITY
OF SUPPLY.

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INFO OCT-01 AID-20 CIAE-00 COME-00 FRB-02 INR-10 NSAE-00

RSC-01 TRSE-00 XMB-07 OPIC-12 SPC-03 CIEP-02 LAB-06

SIL-01 OMB-01 SAM-01 NSC-10 SS-20 STR-08 CEA-02 EUR-25

IO-14 ISO-00 FEA-02 SCI-06 INT-08 L-03 H-03 PRS-01

PA-04 USIE-00 AGR-20 NEA-11 FPC-01 AEC-11 EA-11 AF-10

ARA-16 SSO-00 INRE-00 NSCE-00 DRC-01 /265 W

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11. THE AVERAGE PRICE INCREASE OF CRUDE IN 1974 IS
ESTIMATED AT 180 PERCENT COMPARED WITH AVERAGE PRICES

IN 1973. THE CURRENT LEVEL OF OIL PRICES MAY CHANGE,
HOWEVER, EITHER THROUGH UNILATERAL INCREASES DECIDED
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BY PRODUCING COUNTRIES OR LOWER PRICES NEGOTIATED BY
THE CONSUMING COUNTRIES.

(B) REPERCUSSIONS ON PRICES. FOR THE COMMUNITY
AS A WHOLE THE ADDITIONAL INCREASE IN THE GENERAL
LEVEL OF PRICES IS ESTIMATED AT 2 PERCENT FROM
DIRECT EFFECTS ALONE AND PERHAPS 3 PERCENT WHEN
INCLUDING INDIRECT EFFECTS DUE TO HIGHER INCOMES.
CONSUMER PRICES WILL GO UP A LITTLE LESS. THE MOST
IMPORTANT INCREASES WOULD BE FOR TRANSPORTATION AND
HEATING, BUT MORE THAN AVERAGE INCREASES MAY OCCUR
FOR AGRICULTURAL AND FISHING PRODUCTS AND HOUSING.

(C) EFFECTS ON PRODUCTION AND DEMAND. CONSERVA-
TION AND SUBSTITUTION MEASURES COULD ATTENUATE THE
IMPACT OF THE CRISIS ON MEMBER STATE ECONOMIES. THESE
TRENDS WOULD RESULT PARTLY FROM QUANTITATIVE
RESTRICTIONS AT THE BEGINNING OF 1974 BUT EVEN MORE
FROM HIGHER OIL PRICES. APPRECIABLE ECONOMIES ARE
EXPECTED IN ALL MEMBER STATES BOTH IN FINAL CONSUMPTION
AND INPUTS.

12. TOTAL LOSS OF PRODUCTION FROM PREVIOUS EXPECTA-
TIONS IS ESTIMATED AT 1.5 PERCENT IN 1974, TAKING INTO
ACCOUNT SECONDARY EFFECTS IN THE FORM OF DELAYS
IN CARRYING OUT CERTAIN INVESTMENT PROGRAMS AND THE
PRCHASE OF CONSUMER DURABLES. REAL ECONOMIC GROWTH IN
THE COMMUNITY IN 1974 WOULD NOT EXCEED 2-3PERCENT.
THE EFFECT OF THE ENERGY CRISIS WOULD BE NEGLIGIBLE
IN SOME SECTORS. THOSE MOST AFFECTED WOULD BE CHEMICALS
AND PLASTICS, BOULDING, TEXTILES, CEMENT, GALSS,
CERAMICS, TROUISM, COMMERCE AND CERTAIN OTHER SERVICES,
RUBBER, AUTOMOBILES AND OTHER MEANS OF TRANPSPORTATION.
BOTH OBERALL AND AT THE SECTOR LEVEL, EFFECTS ON
PRODUCTION WOULD APPEAR TO VARY LITTLE FROM ONE MEMBER
STATE TO ANOTHER. ON THE OTHER HAND, TECHNOLOGICAL
INNOVATION AND SUBSTITUTION EFFECTS DUE TO CHANGES
IN RELATIVE PRICES -- AS WELL AS CHANGES IN INVESTOR
AND CONSUMER BEHAVIOR -- COULD CHANGE THE ABOVE
CONSLUSIONS.

(D) EFFECT ON THE LEVEL OF EMPLOYMENT.
ESTIMATED DECREASES IN PRODUCTION COULD LEAD TO A LOSS
IN EMPLOYMENT UNITS (NUMBER OF HOURS WORKED ANNUALLY
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PER WORKER DURING LEGALLY FIXED WORKING TIME)
CORRESPONDING TO ABOUT 0.7 PERCENT OF THE ACTIVE
POPULATION. A REDUCTION IN WORKING HOURS OR LOWERING
IN THE AGE OF RETIREMENT COULD YIELD A RATE OF INCREASE
IN UNEMPLOYMENT THAT WOULD BE LESS THAN THE LOSS OF
EMPLOYMENT UNITS.

13. THE PRINCIPAL BURDEN OF UNEMPLOYMENT WOULD BE IN
A LIMITED NUMBER OF IMPORTANT SECTORS, SPECIFICALLY
CONSTRUCTION, AUTOMOBILES AND OTHER MEANS OF TRANSPORTA-
TION, MECHANICAL CONSTRUCTION, TEXTILES AND CHEMICALS.
THE SERVICES SECTOR WILL ALSO BE AFFECTED DIFFERENTLALLY.
MORE THAN 80 PERCENT OF THE REDUCTION IN DEMAND FOR
SALARIED LABOR IS EXPECTED TO AFFECT THE ABOVE SECTORS.

14. THE PREDICTED REDUCTION IN EMPLOYMENT ASSUMES A
MODERATE CUTBACK IN INVESTMENT. IF MEMBER STATES
FOLLOW ECONOMIC POLICIES HAVING A RESTRICTIVE EFFECT
ON INVESTMENT, EMPLOYMENT IN SECTORS SUCH AS MECHANICAL
CONSTRUCTION AND INDUSTRY COULD DETERIORATE. PARTICU-
LAR ATTENTION SHOULD BE GIVEN TO THE TEXTILE
INDUSTRY.

(E) EFFECT ON BALANCE OF PAYMENT AND MONETARY
RESERVES. EVEN UNDER THE HYPOTHESIS OF A 10 PERCENT
REDUCTION OF OIL IMPORTS IN 1974, THE TRADE AND CURRENT
ACCOUNT BALANCES WILL SUFFER A NET REDUCTION
IN ALL MEMBER STATES. SUPPLEMENTAL COSTS OF OIL
IMPORTATION INTO THE COMMUNITY COULD REACH \$22 BILLION
IN 1974. THIS ESTIMATE, HOWEVER, MUST BE CORRECTED
FOR INDUCED EFFECTS. ON THE ONE HAND THERE COULD BE
ADDITIONAL RECEIPTS FROM BOTH HIGHER EXPORT PRICES AND
FROM A MORE FAVORABLE RATIO BETWEEN THE VOLUME OF
EXPORTS AND IMPORTS. ON THE OTHER HAND, NEW EXPENSES
COULD ARISE FROM THE IMPACT OF HIGHER OIL COSTS ON
THE PRICES OF OTHER IMPORTED PRODUCTS. BASED ON THE
EFFECTS OF THE OIL CRISIS ALONE, THE DETERIORATION IN
THE COMMUNITY'S CURRENT ACCOUNT BALANCE IN 1974 WOULD
BE \$17.5 BILLION, WHICH CORRESPONDS TO MORE THAN 1.5
PERCENT OF COMMUNITY GNP.

15. THE INDIDENCE OF THE OIL PROBLEM ON THE MONETARY
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RESERVES OF THE MEMBER STATES IS FAR MORE UNCERTAIN.
LARGE RECOURSE TO OUTSIDE LOANS WILL BE UNAVOIDABLE.
PREFERENCE SHOULD BE GIVEN TO METHODS OF FINANCING
THAT WILL MINIMIZE BOTH THE RISK OF DISEQUILIBRATING
SHORT-TERM CAPITAL MOVEMENTS AND THE REAL COST OF THE
CAPITAL BORROWED.

16. WHETHER THE FINANCING OF THE DETERIORATION IN
TERMS OF TRADE TAKES PLACE WITH THE AID OF GOLD,
CURRENCY RESERVES OR INTERVENTION ON THE MONEY MARKET,
THERE WILL BE REPERCUSSIONS ON INTEREST RATES AND
INTERNAL LIQUIDITY. THESE REPERCUSSIONS COULD ALSO
AFFECT SAVINGS, INVESTMENT, PRODUCTION AND EMPLOYMENT.
END SUMMARY OF DOCUMENT.GREENWALD

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